

**Internal Revenue Service**  
**Tax Exempt and Government Entities Division**  
Exempt Organizations: Examinations

**Department of the Treasury**

Release Number: **201517011**

Release Date: 4/24/2015

ORG

UIL code: 501.03-13

**Date:**

February 27, 2014

**Taxpayer Identification Number:**

**Form:**

990

**Tax Year(s) Ended:**

March 31, 20XX

**Person to Contact/ID Number:**

**Contact Numbers:**

Telephone:

Fax:

**Manager's name/ID number:**

**Manager's contact number:**

**Response due date:**

March 28, 20XX

**Certified Mail – Return Receipt Requested**

Dear :

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal

standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 3/31/20XX

LEGEND

ORG - Organization name      XX - Date      address - Address      city - City  
state - State

**Issues**

**Issue 1:** Whether ORG is operated exclusively for a tax-exempt purpose and should be considered tax-exempt under Internal Revenue Code section 501(c)(3).

**Issue 2:** Whether ORG is properly classified as not being a private foundation because it is described in Internal Revenue Code Section 509(a)(1), (2), (3) or (4).

**Facts**

ORG (Taxpayer or Organization) was incorporated under the laws of the State of State on October 5, 19XX, as a non-profit domestic corporation.

Form 1023 was received by the Service on May 3, 19XX. In answer to the question in Part II, Number 1, Taxpayer stated that it would participate in three activities: (1) operate a museum, hall of fame and library which will be a "central collection point and depository for any materials dealing with the State National Guard and its forerunner, the State Militia", (2) provide scholarships to "qualified candidates" who are children of members or deceased members of the State National Guard and (3) attempt to raise \$0 to help build a National Guard museum in City, State.

Taxpayer was granted advance ruling tax-exempt status under Internal Revenue Code § 501(a) as an organization described in section 501(c)(3) on August 9, 19XX. Additionally, it was determined not to be a private foundation because it was determined to meet the requirements of IRC§ 509(a)(2) on January 12, 19XX.

In the revised bylaws of Taxpayer, dated April 1, 19XX, Taxpayer states its purpose as establishing in City, State "A permanent display to be known as the State National Guard Memorial Hall and Hall of Fame, open to the public without charge, to contain the art, artifacts and memorabilia of peculiar significance to the State militia and National Guard, and visual representation of dramatic moments in its military history. There will also be displayed the colors of all major commands of the State Army and Air National Guard. A library, open to the public without charge, of books, periodicals and other publications of special interest to historians of the State Militia and the State National Guard."

Article V of the revised bylaws states that "Members of the Foundation shall be all individuals who contribute zero dollars (\$0) or more in support per year." There is no entry for membership dues on any of the Form 990s which were inspected during the examination.

During the examination of Taxpayer, Revenue Agent discovered that the organization was actively engaged in the rental of various real properties from which it earns the major portion of its gross earnings. In addition, the majority of the expenditures of the organization are for the purpose of maintaining these rental properties. Taxpayer files Form 990-T Exempt Organization Business Income Tax Return to report its rental activities.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 3/31/20XX

The addresses and square footage of each of the organization's properties is shown in Table 1, below.

Table 1

<u>Address</u>	<u>Square Footage</u>
Address, City, State Zip code	0 sq. ft.
Address, City, State Zip code	0 sq. ft.
Address, City, State Zip code	0 sq. ft.
Address, City, State Zip code	0 sq. ft.
Total Square Footage Owned	<u>0 sq. ft.</u>

The properties are situated on a parcel of land that consists of four separate buildings located on Address in City, State. This property was conveyed to the organization by The National Guard Association of State, Inc. on January 30, 19XX as a donation.

The buildings consist of Address which is a newer two-story commercial building which currently has two tenants, the Veterans Affairs and Military Affairs branches of the Commonwealth of State. Per a lease agreement between Taxpayer and the State of State a total of 0 sq. ft. of space is leased to the state. The remaining 0 sq.ft. is used in the building located at Address for the organization's historical archive and display.

The museum and library which the organization operates consists of a conference room with wall displays and several bookshelves for books and other papers. During an unscheduled visit to the museum, the Revenue Agent was told that the museum and library were currently locked and would have to be opened by a staff person who works at Address. The Revenue Agent observed no notices or any signage that would indicate that the museum was open to the public at any time without request. In a letter, dated July 10, 20XX and received by the Revenue Agent from the Power of Attorney for the organization, Accountant, CPA, stated that the museum and library were open to the public by appointment.

The buildings at Address and Address are older construction and consist of single story residential tenants and a barber shop. The building at Address appears to be a renovated small house which is leased to The National Guard Association of State. The  
., also has its mailing address at Address.

The properties at Address and Address are leased to various residential tenants and one retail tenant.

The property at Address is leased to the National Guard Association of State.

Taxpayer reported the following gross revenues on its Form 990 for the years ending March 31, 20XX, March 31, 20XX, March 31, 20XX and March 31, 20XX (Table 2):

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
Name of Taxpayer ORG		Year/Period Ended 3/31/20XX

Table 2

	<u>3/31/XX</u>	<u>3/31/XX</u>	<u>3/31/XX</u>	<u>3/31/XX</u>
Contributions	\$0	\$0	\$0	\$0
Investment Income	0	0	0	0
Gross Rents	0	0	0	0
Misc. Income	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Revenues	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Contributions as a percent of Total Revenues	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>
Gross Rents as a percent of Total Revenues	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>

On August 3, 20XX the organization recorded a donation in the amount of \$0 from Donor (Donor). Two donations from Donor were made to the organization during 20XX in the amounts of \$0 and \$0.

Taxpayer has reported no expenses (\$0) for the acquisition or preservation of any art, artifacts, or memorabilia concerning the National Guard of State during the fiscal years ending March 31, 20XX, March 31, 20XX, March 31, 20XX and March 31, 20XX.

Scholarships awarded by Taxpayer totaled \$0 in 20XX, \$0 in 20XX, \$0 in 20XX and \$0 in 20XX. Other donations made by the organization totaled \$0 during the 20XX tax year. No other donations were reported on the Form 990 for the years ending March 31, 20XX, 20XX and 20XX.

There was no mention of an attempt to raise \$0 for the construction of a National Guard museum in City, State in any of the four Form 990s. In a written answer to a Form 4564 Information Document Request, dated January 29, 20XX, Taxpayer indicated that it had no records of whether it had ever raised this money or donated it to help with the construction of a National Guard Museum in City, State.

The minutes of Taxpayer's board of directors were requested and provided by Taxpayer for the period May, 20XX to the present. Minutes were requested and not provided for the period April, 20XX through April, 20XX. There was no mention in the minutes that were provided of any activity pertaining to the museum, artifacts obtained or visitor information. Items noted in the minutes chiefly concerned the rental properties owned by Taxpayer and rented to the general public. (See Appendix 1.)

As a 509(a)(2) type organization, Taxpayer is required to file Form 990 (Schedule A). Taxpayer has consistently filed this form as if the organization is tax-exempt under IRC §170(b)(1)(A)(vi). During the course of the examination it was discovered that the Form 990

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 3/31/20XX

(Schedule A) submitted by the taxpayer was not correctly prepared. Revenue Agent used information provided by the organization to prepare corrected Schedule A's for Taxpayer's tax periods ending March 31, 20XX, March 31, 20XX, and March 31, 20XX. (See Appendix 2.) The data used to compute the Public Support Percentage was obtained from the previously filed Form 990s of the Taxpayer. These corrected forms were mailed to the Taxpayer on April 16, 20XX with a request for comment. Taxpayer replied that it did not agree with the corrections but did not offer any explanation as to why it did not agree.

### Law

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a) states that "In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

The organizational test states in that "An organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its articles) as defined in subparagraph (2) of this paragraph:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes." (Treas. Reg. § 1.501(c)(3)-1(b))

The operational test states that "An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose." (Treas. Reg. § 1.501(c)(3)-1(c))

Treas. Reg. § 1.501(c)(3)-1(d)(i) states that "An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes: (a) Religious, (b) Charitable, (c) Scientific, (d) Testing for public

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 3/31/20XX

safety, (e) Literary, (f) Educational, or (g) Prevention of cruelty to children or animals.”

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(c)(3)-1(e)(1) states that “An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization’s exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3).”

IRC § 513(a) states that an unrelated trade or business is one which is “any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.”

Treas. Reg. § 1.509(a)-3(a) states that “Section 509(a)(2) excludes certain types of broadly, publicly supported organizations from private foundation status. An organization will be excluded under section 509(a)(2) if it meets the one-third support test under section 509(a)(2)(A) and the not-more-than-one-third support test under section 509(a)(2)(B).”

Treas. Reg. § 1.509(a)-3(a)(2) states that “An organization will meet the one-third support test if it normally receives from permitted sources more than one-third of its support in each taxable year from any combination of--

(i) Gifts, grants, contributions, or membership fees; and

(ii) Gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity that is not an unrelated trade or business (within the meaning of section 513), subject to certain limitations.”



Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b> ORG		<b>Year/Period Ended</b> 3/31/20XX

### **Issue 1**

#### **Taxpayer's Position**

Unknown

#### **Government's Position**

The organization described three tax-exempt purposes in its Form 1023: (1) operating a museum, hall of fame and library, (2) providing scholarships, and (3) raising money for a National Guard museum in City, State. All of these purposes can be considered to be tax-exempt purposes under the organizational test in Treas. Reg. § 1.503(c)(3)-1(b) and Treas. Reg. § 1.501(c)(3)-1(d)(i). Organization, therefore, passes the organizational test.

Taxpayer is not actively pursuing the stated activity of operating a museum, hall of fame and library. There have been no expenditures made in the previous four years that indicate any activity in the area of operating a museum, hall of fame or library. No money has been spent on the acquisition or preservation of any art, artifacts, or memorabilia. Minutes from the board of directors meetings do not mention any activity concerning the museum, hall of fame or library directly. The minutes indicate that the meetings of the board of directors were concerned with the rental properties only.

Additionally, Taxpayer has stated that it doesn't have any records to show whether there was ever a \$0 contribution made to help in the construction of a National Guard museum in City, State.

In the area of scholarships, Organization has granted only very small amounts of money to its scholarship program in relation to the amount of gross revenue that is being produced by the rental properties.

The lack of any financial support and the fact that there was no discussion of the museum at board of directors meetings show that there is little or no activity in conducting the main purpose for which Organization applied for tax-exemption. Also, there appears to have been such little activity in the contribution to the National Guard museum that the organization does not even have any records of whether the contribution, which also was part of its determination application, was ever made. Finally, the dollar amount of the scholarships which was the third tax-exempt activity mentioned in the determination application is very low when compared with the gross rental revenue that Taxpayer receives yearly.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 3/31/20XX

Taxpayer has shown little or no activity in the areas in which it applied for tax-exempt status.

In order to pass the operational test, Organization must be operated exclusively for tax-exempt purposes and any activities that are not in furtherance of an exempt purpose must be insubstantial as per Treas. Reg. § 1.501(c)(3)-1(c).

The purposes for which an organization may be tax-exempt are laid out in Treas. Reg. § 1.501(c)(3)-1(e)(1). While Organization meets the criteria of a charitable organization with regards to its organizational documents and it does have a number of display cases in the State National Guard offices, the organization's primary activity is operation of a rental business.

Table 1, in the Facts section of this document, shows that the organization owns four separate properties. The total square footage of these properties is 0 square feet. Taxpayer has identified 0 square feet of space as being utilized by its historical archive and display. Thus, only 0% of the total square feet that the organization owns is used for its tax-exempt activities.

As can be seen in Table 2, contributions form a very small part of the gross revenue of the organization. During the examination year, contributions amounted to 0% of gross revenue. Previous years' contribution rate was even smaller.

Organization has consistently filed Form 990-T to report its rental activities as the properties being rented are debt financed.

The facts have shown that the primary purpose of this organization is to operate a real estate rental service. Due to the extent of the rental activities, the lack of any activity or discussion of the museum, the lack of any records concerning the donation to the National Guard museum in , and the small amount of money that has been committed to scholarships it has been determined that Taxpayer has failed to meet the test described in Treas. Reg. § 1.501(c)(3)-1(e)(1) because the organization is "organized and operated for the primary purpose of carrying on an unrelated trade or business". Taxpayer cannot be considered to be exempt under section 501(c)(3) because its primary purpose is carrying on an unrelated trade or business, the rental of real estate properties.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
<b>Name of Taxpayer</b> ORG		<b>Year/Period Ended</b> 3/31/20XX

## Conclusion

ORG, based on the analysis above, is not an exempt organization under IRC § 501(c)(3). The tax exemption for this organization should be revoked as of April 1, 20XX.

## Issue 2

### Taxpayer's Position

Unknown

### Government's Position

An IRC section 509(a)(2) type organizations is required to be considered a private foundations unless it is able to meet the one-third support test under section 509(a)(2) and the not-more-than-one-third support test under section 509(a)(2)(b).

A taxpayer will meet the one-third support test if it normally receives more than one-third of its support from a combination of gifts, grants, contributions or membership fees and gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity that is not an unrelated trade or business, subject to certain limitations.

Taxpayer claims to be tax-exempt by virtue of being classified under IRC section 501(c)(3) and claims to receive a substantial portion of its support from a governmental unit or from the general public as described in IRC section 170(b)(1)(A)(vi). It is therefore required to file Form 990 Schedule A each year which it has consistently done.

As part of the examination of Taxpayer, the Revenue Agent recalculated the Form 990 Schedule A for the tax years ending March 31, 20XX, March 31, 20XX, and March 31, 20XX. (See Appendix 2)

In each of the four years in which the Public Support Percentages were calculated for Part II of Form 990 Schedule A Taxpayer failed to pass the one-third support test. Additionally, Taxpayer was unable to pass the one-third support test in Part III of Form 990 Schedule A for any of the four years.

Although Taxpayer was requested to provide an explanation as to whether it agreed with the corrected Form 990 Schedule As, it did not provide any documentation or explanation to refute the corrected Form 990 Schedule As.

Accordingly, Taxpayer should be considered to be a private foundation.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 3/31/20XX

### Conclusion

If the organization's tax-exempt status is not revoked, ORG should henceforth be considered to be a private foundation within the meaning of the law.